

Decision 01-05-092

May 24, 2001

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks.

R.93-04-003
(Filed on April 7, 1993)

Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.

I.93-04-002
(Filed April 7, 1993)

**ORDER MODIFYING AND DENYING REHEARING
OF DECISION 99-11-050**

I. INTRODUCTION

In Decision (D.) 99-11-050, the Commission adopted prices for unbundled network elements (UNEs) offered by Pacific Bell (Pacific). The decision completes the costing and pricing for Pacific's UNEs that the Commission began in 1996 in the Open Access and Network Architecture Development (OANAD) proceeding.

In 1996, the Commission approved cost studies prepared by Pacific, and modified by the Commission, that were based on the Total Service Long Run Incremental Cost (TSLRIC) methodology. (Re Open Access and Network Architecture [D.96-08-021] (1996) 67 Cal.P.U.C.2d 221.) However, the task of setting prices was suspended by the administrative law judge (ALJ) after the

Federal Communications Commission (FCC) issued its “First Report and Order,” which implemented the local competition provisions of the 1996 Telecommunications Act (Act).¹ (See ALJ’s Ruling Suspending Briefing Schedule and Inviting Comments on the Impact of the August 8, 1996 First Report and Order of the FCC, August 21, 1996.) The First Report and Order designated the use of total element long run incremental costs (TELRIC) for pricing UNEs, thus calling into question the legal adequacy of the TSLRIC methodology. In December of 1996, the ALJ directed Pacific to submit cost studies consistent with the TELRIC methodology. (ALJ’s Ruling Concerning Impact of the August 8, 1996 First Report and Order of the FCC on this Proceeding, December 18, 1996.)²

In D.98-02-106, the Commission decided to use the TELRIC methodology for pricing UNEs. The Commission approved TELRIC studies submitted by Pacific, after ordering significant modifications. The Commission further stated that it would hold supplementary hearings on pricing.

¹ In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 15499 (1996) (First Report and Order).

² Although the FCC rules requiring TELRIC had been stayed by the Eighth Circuit Court of Appeals in Iowa Utilities Board v. FCC (8th Cir. 1996) 109 F.3d 418, the ALJ noted in his December 1996 ruling that the FCC rules might eventually be reinstated, and that the TELRIC methodology appeared to have several advantages over TSLRIC.

On January 25, 1999, the United States Supreme Court issued its decision in AT&T v. Iowa Utilities Board (1999) 525 U.S. 366, reversing the Eighth Circuit on key jurisdictional issues. Among other things, the Court upheld the authority of the FCC to prescribe a pricing methodology. In addition, the Court vacated Rule 319 (47 C.F.R. § 51.319), which sets forth the list of elements that incumbent local exchange carriers (ILECs) must offer to competitive local exchange carriers (CLECs) on an unbundled basis. The Court remanded the case to the Eighth Circuit to rule on the merits of TELRIC pricing.

On July 18, 2000, the Eighth Circuit ruled that to the extent the FCC’s mandated TELRIC rule relies on a hypothetical network standard, it violates the Act’s requirement that UNE rates be based the cost of providing the element. (Iowa Utilities Board v. FCC (8th Cir. 2000) 219 F.3d 744.) However, that decision was stayed pending the United States Supreme Court’s consideration of petitions for certiorari that were filed by various parties in the Eighth Circuit case. On January 22, 2001, the Supreme Court granted petitions for certiorari on, among other issues, whether the Eighth Circuit erred in holding that the FCC’s TELRIC rule violates the Act.

On March 16, 1998, a prehearing conference was held to discuss issues expected to arise during the supplementary pricing hearings. The ALJ issued a ruling on March 28, 1998 that set forth the issues to be addressed and the nature of testimony to be filed in subsequent hearings. Hearings were held for three and a half weeks from May 18, 1998 to June 10, 1998. Opening and reply briefs were filed.

On May 10, 1999, an ALJ proposed decision was mailed to the parties. After comments were filed, a final decision was issued on November 18, 1999. The instant decision, D.99-11-050, adopts prices for UNEs equal to TELRIC plus a markup of nineteen percent (19%) to recover shared and common costs. The decision also adopts price floors for certain local exchange services and a methodology for determining the prices of various types of UNE combinations specified in the interconnection agreements that have been approved since 1996.

Joint applications for rehearing were filed by AT&T Communications of California, Inc. ("AT&T") and MCI WorldCom Network Services, Inc. ("MCI" or "MCI WorldCom"), and by Time Warner Telecom of California, L.P. ("Time Warner") and Cox California Telcom, L.L.C. d/b/a Cox Communications ("Cox"). Applications for rehearing were also filed by Pacific, California Cable Television Association ("CCTA"), and The Utility Reform Network ("TURN"). Responses were filed by AT&T/MCI, Cox, Pacific, CCTA, the Office of Ratepayer Advocates ("ORA"), and Covad Communications Company ("Covad"). In addition, AT&T/MCI filed a motion for leave to file under seal the proprietary version of their joint application for rehearing. New Edge Network, Inc. d/b/a New Edge Network ("New Edge") filed a petition for leave to participate in the proceeding in opposition to Pacific's application for rehearing. Time Warner/Cox and CCTA request oral argument on the issues raised in their applications for rehearing.

We have reviewed each and every allegation of error raised in the applications for rehearing and are of the opinion that applicants have not presented sufficient grounds for granting rehearing. Therefore, the applications for rehearing of D.99-11-050 are denied. However, we will modify the decision in order to eliminate inconsistencies on the issue of DSL Conditioning.

II. DISCUSSION

A. Joint Application of AT&T/ MCI

AT&T/MCI argue that (1) the decision errs in failing to deaverage the UNE loop price as required by the Act and FCC regulations; (2) the decision violates the Act by adopting prices for unbundled switching that are not cost-based; and (3) the decision's adoption of a 19% shared and common cost markup does not properly reflect the factual record.

1. Deaveraging

In the First Report and Order, the FCC determined that because there are large geographic variations in the costs of UNEs, the cost-based requirements of the Act necessitate geographically deaveraged rates. (First Report and Order, ¶ 764) The FCC concluded that states should create a minimum of three cost-related rate zones to implement deaveraged rates. (First Report and Order, ¶ 765) This determination was codified in 47 C.F.R. § 51.507(f). The rule was initially vacated by the Eighth Circuit Court of Appeals (see Iowa Utilities Board v. FCC (8th Cir. 1997) 120 F.3d 753, 800, fn. 21), but was later reinstated by the United States Supreme Court's decision in AT&T v. Iowa Utilities Board (1999) 525 U.S. 366. In order to allow states time to comply with the reinstated deaveraging requirements, the FCC granted a stay of the rule on May 7, 1999, which was lifted on May 1, 2000.

The decision adopts statewide average UNE prices, acknowledging that the FCC requires geographic deaveraging. However, the decision concludes that the record in this case is simply not adequate to determine deaveraged costs.

The decision notes that the Commission intends to begin proceedings to determine deaveraged prices in the near future. In fact, on March 2, 2000, the Commission issued an order instituting investigation (“OII”) into the deaveraging of unbundled network elements pursuant to FCC Rule 51.507(f). On August 10, 2000, Pacific, AT&T and MCI WorldCom filed a proposed settlement agreement on deaveraging.³

AT&T/MCI contend that the decision’s failure to deaverage UNE loop prices violates the FCC regulations on deaveraging and violates the Act because the resulting prices are not cost-based and are discriminatory.

AT&T/MCI argue that the Commission should either grant rehearing on this issue or establish an expeditious schedule for putting deaveraged prices in place no later than May 1, 2000. AT&T/MCI allege that a main consequence of the failure to deaverage loop prices is that competitors cannot use UNEs to serve residential customers without losing money. According to AT&T/MCI, Pacific can price retail residential services below the price floor adopted for flat-rate residential basic exchange service because it receives subsidies from the universal service fund and Pacific’s yellow pages net revenues. Because competitors do not have access to such subsidies, AT&T/MCI assert that the pricing adopted in the decision is discriminatory.

AT&T/MCI do not dispute that there is an inadequate record on which to base deaveraged rates. Instead, AT&T/MCI argue that the decision improperly rejects their alternative approach, which is to give competitors who purchase unbundled loops from Pacific access to the universal service subsidies for basic residential service. Although Pacific also proposed a division of universal service funds between the incumbent local exchange carrier (ILEC) and the competitive local exchange carrier (CLEC), the decision rejects both proposals. The decision

³ After parties filed comments on the proposed settlement, the ALJ ordered parties to comment on deaveraging proposals made prior to the settlement. Those comments were submitted in December 2000. A decision in that case is still pending.

explains in detail the reasons for rejecting these proposals. As explained there, (1) MCI/AT&T's surcredit proposal is inconsistent with the 1996 Act; (2) the universal service funds that AT&T/MCI proposes to use for the surcredit have already been allocated toward permanent rate reductions; and (3) both Pacific's and AT&T/MCI's proposals are inconsistent with the purposes of the universal service fund. (D.99-11-050 at pp. 93-99.)

AT&T/MCI admit that their proposal to obtain the universal funds on a statewide average basis is "a back-door method for solving the need for deaveraged loop prices . . . and gives rise to some harmless imprecision." (AT&T/MCI Application at p. 15.) Nevertheless, AT&T/MCI contend that the decision rejects their proposal for reasons that do not have a valid basis in the record.

AT&T/MCI raised many of the same objections in their comments to the proposed decision. Those objections are addressed in the final decision. (D.99-11-050 at pp. 93-99.) Although AT&T/MCI quarrel with some of the decision's conclusions on this issue, they fail to demonstrate that rejection of their proposal is legal error.

2. Non-cost-based Switching Rates

AT&T/MCI also argue that the decision errs in adopting prices for unbundled switching that are not cost-based, thus violating the 1996 Act. AT&T/MCI contend that the decision violates the 1996 Act because the underlying TELRIC switching costs exceed forward-looking economic costs, and that the decision errs in failing to include all vertical features the switch is capable of providing as part of the port element of the switching UNE.

a) TELRIC Switching Costs

AT&T/MCI assert that the underlying TELRIC switching costs exceed Pacific's current switching costs, and that switching costs will continue to decline in the future. AT&T/MCI contend that this problem is aggravated by the

decision's conclusion that future arbitration agreements will be bound by these prices.⁴ (D.99-11-050 at pp. 167-168, 265, Conclusion of Law No. 70.)

The prices adopted in the decision are based on TELRIC costs adopted in D.98-02-106, which, in turn, are based on TSLRIC costs adopted in D.96-08-021. Thus, as the decision acknowledges, the costs adopted in 1998 are based largely on data that has not been updated since 1994. The decision also notes that there is evidence that some of these costs may be changing rapidly. (D.99-11-050 at p. 168.) Recognizing that it may be several years before the Commission will be able to undertake a general reexamination of UNE costs, the decision sets up an interim procedure for reexamining individual UNE costs annually. Pursuant to this procedure, Pacific or a CLEC can nominate a UNE for reexamination if the carrier believes that there is at least a 20% difference between the costs approved in D.98-02-106 and current costs. The Commission will then choose no more than two UNEs for the annual cost reexamination. (D.99-11-050 at pp. 168-169, 265, Conclusion of Law No. 69.)

Because of the complexities involved in establishing UNE costs and prices, there is necessarily a lag time between the period when original cost studies were prepared by Pacific Bell and the date that the Commission adopted prices for UNEs. The delay in this case was exacerbated by the passage of a new statutory framework for competition in local exchange services, the 1996 Act, new regulations implementing the statute, and subsequent changes in the applicable law because of various court rulings. For example, pricing hearings based on TSLRIC were held for five weeks beginning in July of 1996, but were abandoned when the FCC's First Report and Order was issued requiring TELRIC pricing. (See ALJ's Ruling Suspending Briefing Schedule and Inviting Comments on the Impact of the August 8, 1996 First Report and Order of the FCC, August 21, 1996.) Thus, even assuming the cost data used for pricing UNEs is now out-of-

⁴ AT&T/MCI allege that switching prices based on 1996 switching costs could be as much as 40% above Pacific's costs by the end of a three-year contract that is established this year.

date, it is difficult to see how this can be remedied without starting the whole process over.

In addition, AT&T/MCI's arguments actually challenge the underlying costing decisions, rather than the instant pricing decision. As pointed out by Cox, AT&T/MCI are asking the Commission to reconsider issues resolved in decisions that have long been final, i.e., D.95-12-016 (Re Open Access and Network Architecture Development (1996) 62 Cal.P.U.C.2d 575), which adopted Consensus Costing Principles for defining forward-looking, long-run costs; D.96-08-021 (Re Open Access and Network Architecture Development (1996) 67 Cal.P.U.C.2d 221), which adopted TSLRIC costs studies; and D.98-02-106, which adopted TELRIC cost studies.⁵ The time for filing applications for rehearing of those decisions has passed. (Pub. Util. Code § 1731.)

Finally, as stated above, the Commission has established a procedure for reexamining individual UNE costs in cases where there appears to be a significant difference between the adopted costs and the current costs. AT&T/MCI do not even mention the annual cost reexamination procedure in their application, nor do they explain why that procedure does not address their concerns. For all of these reasons, even if AT&T/MCI are correct that switching costs have declined, they have not demonstrated legal error in the instant decision.

b) Pricing of Vertical Features

AT&T/MCI assert that the Commission violated the FCC's requirement that the switching UNE include all the features and functions of the switch. According to AT&T/MCI, the Commission approved prices for vertical features separate and in addition to the port element of the switch, thus "effectively allowing Pacific to delete vertical features from the switching unbundled network element." AT&T/MCI also contend that the Commission

⁵ AT&T/MCI sought and were denied rehearing of D.98-02-106 on the issue of geographic deaveraging. (See D.98-12-028 [denying rehearing of D.98-02-106].)

allowed Pacific to cost out only a very small portion of the possible switch features (97 out of 1,000), which precludes a competitor from ever obtaining the vast majority of the features inherent in the switch. AT&T/MCI argue that the Commission's failure to adequately explain its decision regarding vertical features is a violation of Public Utilities Code section 1705, which requires a decision to contain separately stated findings of fact and conclusions of law on all issues material to the decision. AT&T/MCI conclude that the Commission should grant rehearing and order Pacific to include all vertical features that the switch is capable of providing as part of the port element of the switching UNE.

Pacific responds that AT&T/MCI have somewhat altered their argument since hearings on this issue. According to Pacific, AT&T/MCI initially argued that all vertical switch features should be included in a single port price. AT&T/MCI now argue that there is legal error because some, but not all, of the features were priced as unbundled elements.

The FCC has defined the local switching element to encompass "the features, functions, and capabilities" of the switch, which include "all vertical features that the switch is capable of providing, including custom calling, CLASS features, and Centrex, as well as any technically feasible customized routing functions."⁶ (First Report and Order, ¶ 412.) However, while the FCC included vertical features in the definition of the switching UNE, it did not prohibit the unbundling of these features for pricing purposes. The FCC declined to require further unbundling of the local switch into a basic switch element and independent vertical feature elements because (1) such unbundling does not appear necessary to promote local competition, (2) additional unbundling would not result in a practical difference in the way the local switching element is provided, and (3) the small incremental costs associated with vertical features on a per-line basis may

⁶ AT&T/MCI states that custom calling features include call waiting, three-way calling, and call forwarding. CLASS features that rely on the transmission of signaling information between the calling and called parties, such as caller ID and call return, are also vertical features.

not justify the administrative difficulty for the incumbent LEC or the arbitrator to determine a price for each vertical element. The FCC concluded that states may investigate, in arbitration or other proceedings, whether vertical switching features should be made available as separate network elements. (First Report and Order, ¶ 414.)

Nothing in the instant decision states or implies that LECs are not obligated to provide vertical features as part of the switching UNE. Rather, the decision sets separate prices for certain vertical features that have been specified in interconnection agreements approved since 1996. (See D.99-11-050 at pp. 3, 296, Ordering Paragraph No. 3.) Precisely because there are so many possible switch features (about 1,000 according to AT&T/MCI), the Commission only required Pacific to price the features that were included in existing agreements. However, if and when other features are requested, the prices for those features may be established in an arbitration proceeding, based on the costing principles adopted in this docket.⁷ This approach is clearly not prohibited by the FCC rules that are cited by AT&T/MCI.

Finally, this argument is essentially a challenge to the previous costing decision rather than to the instant pricing decision. For all of the foregoing reasons, AT&T/MCI have failed to show that there the decision legally errs by only setting prices for those vertical features that were included in the then-existing interconnection agreements.

3. Shared and Common Cost Markup

AT&T/MCI contend that the Commission's decision to adopt a 19% shared and common cost markup does not properly reflect the factual record because (1) the decision fails to reflect that common costs are common to the entire firm, and (2) the decision unlawfully allows Pacific access to yellow pages

⁷ In its response, Pacific states that any CLEC can use the Interconnection Network Element Request ("INER") process for establishing new UNEs to obtain vertical switch features not currently priced. However, that process is intended to apply to changes in existing agreements.

revenue to offset the shared and common cost markup for residential unbundled loops.

a) Common Cost Factor

ATT/MCI argue that the decision fails to reflect that common costs are common to the entire firm. According to AT&T/MCI, the decision errs (1) in concluding that Pacific's retail costs should not be added to the denominator of the markup calculation, and (2) by failing to include Category III service costs in the calculation of the shared and common cost markup.

Pacific responds that AT&T/MCI is simply re-litigating issues from the TELRIC costing phase of OANAD. According to Pacific, the TELRIC costing phase produced common costs of a wholesale only firm, and did not include Category III services as part of the cost structure. Thus, it would be inconsistent to add retail costs to the denominator of the markup calculation, and to include Category III service costs as part of the cost structure.

The decision finds that it would be unfair to Pacific and inconsistent with the TELRIC methodology to include retail-related costs in the shared and common cost markup for UNEs. (D.99-11-050 at p. 64.) Similarly, the decision finds that it would be unfair to include Category III services in the denominator, "since these services have their own separate shared and common costs." (D.99-11-050 at pp. 65-66.) AT&T/MCI raised these issues in their testimony and in comments to the ALJ's proposed decision. (See D.99-11-050 at p. 64, fn. 63.) Now, AT&T/MCI are again raising these same issues that have been rejected twice before. Moreover, the decision, relying in part on Pacific's testimony, explains why it rejects AT&T/MCI's position (D.99-11-050 at pp. 63-66), and expands on that explanation in response to AT&T/MCI's comments to the proposed decision (D.99-11-050 at pp. 64-65, fn. 63). AT&T/MCI have failed to demonstrate that either the reasoning or the result of the decision is in error.

b) Access to Yellow Pages Revenue

AT&T/MCI also allege that the decision unlawfully allows Pacific access to a portion of Yellow Pages revenue to offset the shared and common cost markup for residential unbundled loops, while denying competitors non-discriminatory access to that same subsidy. AT&T/MCI's argument is largely premised on their incorrect assumption that, with the exception of one finding of fact, the decision fails to discuss this issue. (See AT&T/MCI Application at p. 24.) In fact, the decision devotes ten pages to this issue, including a reasoned discussion of why the Commission rejects AT&T/MCI's proposal. (D.99-11-050 at pp. 74-83.) Although AT&T/MCI disagrees with the Commission's reasoning on this issue, they have not demonstrated legal error.

B. Pacific's Application

Pacific argues that the decision contains the following errors: (1) setting the shared and common cost allocator at 19% rather than the 21% approved in D.98-02-106 (the OANAD costing decision) and Resolution T-16204 (which approved Pacific's compliance filing); (2) setting nonrecurring prices that are below cost; (3) refusing to set a rate for recurring operation support services (OSS) costs; (4) setting UNE prices which do not include rearrangement expenses; (5) setting an erroneous rate for DSL conditioning; and (6) using TELRIC as the sole basis for the pricing decision.

1. Shared and Common Cost Allocator

Pacific argues that the decision errs in setting the shared and common cost allocator at 19% rather than the 21% approved in D.98-02-106 and Resolution T-16204. AT&T/MCI respond that the decision and resolution cited by Pacific only adopted costs for Pacific, and did not determine any specific application of those costs.

In hearings, Pacific proposed to calculate the shared and common cost markup by dividing the total shared and common costs for all UNEs (as approved

in D.98-02-106) by the total direct TELRIC costs for all UNEs (as approved in the same decision). The decision adopts Pacific's approach, with one adjustment; the decision adds \$375 million of non-recurring costs (adopted in D.98-12-079) to the total direct costs (adopted in D.98-02-106) used to compute the markup, i.e. to the denominator of the fraction. After rounding, this results in a markup of 19%. (See D.99-11-050 at pp. 62-63.)

Pacific claims that the total direct costs approved in D.98-02-106 already include \$500 million in non-recurring costs, as identified by Pacific in workpapers filed on January 13, 1997. Thus, according to Pacific, adding the \$375 million to the total direct costs results in a double counting of non-recurring costs. In its comments to the proposed decision, Pacific made the same argument it makes here. As explained in the decision, the costs found reasonable in D.98-02-106 were recurring costs only. The non-recurring costs of \$375 million were adopted in D.98-12-079. In order to obtain total recurring and non-recurring TELRIC costs, the two figures must be added together. (See D.99-11-050 at p. 71, fn. 71.) Thus, there is no merit to Pacific's argument that the formula results in double counting.

2. Nonrecurring Prices Below Cost

Pacific contends that the decision's non-recurring prices, based solely on D.98-12-079, are below cost. However, Pacific's arguments all focus on D.98-12-079, the non-recurring costing decision. Pacific does not allege any errors in the pricing decision on this point. As stated above, in relation to AT&T/MCI, the time for filing applications for rehearing of those decisions has passed. (Pub. Util. Code § 1731.)⁸ Therefore, Pacific has failed to demonstrate legal error.

⁸ Although other parties filed applications for rehearing of D.98-12-079, Pacific did not. (See D.99-06-060, modifying D.98-12-079 and denying rehearing.)

3. Recurring Operations Support Services Costs

Pacific claims the decision errs by failing to set a recurring price for the use of Pacific's operations support systems ("OSS"). Pacific points out that the FCC has determined that OSS functions must be offered by ILECs as an unbundled network element under the Act. (See In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 15 FCC Rcd 3696 (1999), ¶ 433 (Third Report and Order).)

In D.98-12-079, the OANAD non-recurring cost decision, the Commission considered recurring costs associated with providing gateways to OSS. The Commission found that the OSS cost studies presented by both Pacific and GTE California, Incorporated ("GTEC") did not "demonstrate reasonable and supported expenses associated with implementing, developing, and maintaining OSS systems and databases that should be directly assigned to competitors," and rejected the studies. (D.98-12-079 at p. 46.) However, the Commission noted that OSS implementation costs were being handled in the Local Competition Proceeding (A.95-04-043/I.95-04-044). (D.98-12-079 at pp. 42-43.) The Commission stated: "If Pacific and GTEC believe these costs qualify for recovery as implementation costs in the Local Competition proceeding, they may seek to recover any eligible costs through the memorandum account procedure established in that docket." (Ibid.)

As pointed out in AT&T/MCI's response, on August 24, 1999, Pacific sent a letter to the ALJ in the Local Competition proceeding, which stated: "Although, the CPUC in D.98-12-079 allowed Pacific to seek recovery of recurring costs associated with access to OSS, Pacific has chosen not to seek recovery of recurring OSS access costs in this proceeding." (Letter from Debra Clemens to ALJ Pulsifer, August 24, 1999.)

Pacific now is arguing that an interim OSS rate must be set, pending additional cost studies. Pacific contends that this is required by the Act, and that

referring the issue to the Local Competition proceeding, as the Commission did in D.98-12-079, does not comply with the Act.

The Act requires ILECs to provide nondiscriminatory access to unbundled network elements at a rate that is “just, reasonable, and nondiscriminatory.” (47 U.S.C. § 251(c)(3).) The Act further provides that determinations by a State commission of the just and reasonable rate under 251(c)(3) shall be nondiscriminatory and based on the cost (determined without reference to a rate-of-return proceeding) of providing the network element, and may include a reasonable profit. If Pacific has failed to submit cost studies that allow the Commission to determine a just and reasonable OSS rate, as D.98-12-079 found, it cannot claim that the Commission has violated the Act. Moreover, as stated above, Pacific was given another opportunity to prove the reasonableness of its recurring OSS access costs in the Local Competition proceeding and specifically elected not to do so.

Finally, Pacific did not apply for rehearing of the Commission’s decision in D.98-12-079. (See D.99-06-060 [addressing applications for rehearing of D.98-12-079].) Although the instant decision determines pricing, it is obvious from the language in D.98-12-079 that recovery of OSS costs was to going to be determined in the Local Competition proceeding. If Pacific objected to this, it should have challenged the 1998 decision. An application for rehearing of the instant decision is not the proper procedure for challenging a determination made in D.98-12-079.

4. Rearrangement Expenses

Pacific contends that the decision errs in setting UNE prices that do not include rearrangement expenses. Loop plant rearrangement costs are those costs associated with moving current facilities to serve existing demand. In D.96-08-021 (Re Open Access and Network Architecture Development (1996) 67 Cal.P.U.C.2d 221), the Commission disallowed a substantial portion of

rearrangement expenses claimed by Pacific under the TSLRIC methodology. Pacific alleges that the Commission disallowed these expenses because a forward-looking network would not include such costs. Pacific further contends that, since the 1996 decision, the FCC has ruled that rearrangement-type expenses are recoverable under TELRIC.

Pacific's arguments are without merit for several reasons. First, Pacific mischaracterizes the 1996 decision. In D.96-08-021, the Commission excluded a substantial portion of claimed rearrangement expenses based on Public Utilities Code section 2883, which requires all LECs to equip residential telephone lines with access to 911, and prohibits the LECs from terminating access because a customer moves or fails to pay a telephone bill. The Commission explained that the effect of this legislation on rearrangement expenses is significant because it effectively requires a large number of existing "active" residential lines to be in place at all times. The Commission also excluded other portions of the rearrangement expenses because it found that Pacific had the capability to determine where demand for additional distribution and feeder will occur. Moreover, the Commission expressly stated that it was not excluding the rearrangement expenses for the reason given by the California Telecommunications Coalition, i.e., because such costs are inappropriate for a forward-looking cost study.⁹ (Re Open Access and Network Architecture Development, *supra*, 67 Cal.P.U.C.2d at pp. 242-243.)

Second, the FCC rulings cited by Pacific do not require the Commission to allow the expenses in question under the circumstances present here. Pacific argues that since the 1996 decision, the FCC has ruled in analogous situations that such rearrangement-type expenses are recoverable under TELRIC. Pacific states, with respect to collocation, the FCC has ruled that expenses involving rearrangement of central office equipment to make room for collocation

⁹ Although the decision adds that significant rearrangement expenses are more consistent with an embedded cost study than a TSLRIC study, this is clearly not the primary basis for the disallowance.

are recoverable. Pacific cites In the Matter of Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switch Transport, 12 FCC Rcd 18730 (1997), ¶ 63 (Second Report and Order), which allows recovery of costs for “common floor reconditioning.”

Pacific further contends that, similarly, the FCC has ruled that the costs of conditioning loops to carry DSL traffic are recoverable expenses. Pacific relies on In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 15 FCC Rcd 3696 (1999), ¶ 193 (Third Report and Order). The Third Report and Order does state that LECs should be able to charge for loop conditioning. (Third Report and Order, ¶ 193.) However, the Third Report and Order also states:

We recognize that the charges incumbent LECs impose to condition loops represent sunk costs to the competitive LEC, and that these costs may constitute a barrier to offering xDSL services. We also recognize that incumbent LECs may have an incentive to inflate the charge for line conditioning by including additional common and overhead costs, as well as profits. We defer to the states to ensure that the costs incumbents impose on competitors for line conditioning are in compliance with our pricing rules for nonrecurring costs.

(Third Report and Order, ¶ 194, emphasis added.)

While these FCC rulings may support the recovery of rearrangement expenses in theory, they do not mandate that the Commission approve the costs at issue here. In this case, the Commission concluded that the requirements of Public Utilities Code section 2338, together with Pacific's ability to determine where additional demand will occur, minimize the need for rearrangement. Pacific does not even address these issues in its application.

Finally, even if Pacific could demonstrate that FCC rulings issued subsequent to D.96-08-021 require the Commission to review its 1996 decision,

the appropriate procedure would be to file a petition for modification of that decision, rather than an application for rehearing of the instant decision.

5. DSL Conditioning

Pacific asserts that the DSL conditioning rate is in error. According to Pacific, the decision recognizes that Pacific incurs costs for conditioning DSL lines and finds that such costs should be recovered. (D.99-11-050 at p. 113.) However, the decision then assigns a nonrecurring charge for DSL loops that is the same as for unbundled loops that require no conditioning. (See D.99-11-050, Appendix B, pp. 13 and 14 [compare “Basic Link” and “ISDN Link”].) Thus, Pacific argues, the decision allows no recovery for loop conditioning. Pacific further contends that because the reasoning of the decision does not support the price adopted, the decision is arbitrary and capricious. AT&T/MCI respond that the cost of any necessary conditioning is already included in Pacific’s reported price for the DSL loop element.

We agree with Pacific that there appear to be some internal inconsistencies in the decision. However, we believe that the decision did not intend to allow recovery of additional costs above those included in the nonrecurring ISDN loop price shown in the Appendix B. As stated in the decision, the loop conditioning costs in Pacific’s proposal were very high and were based on embedded costs. (D.99-11-050 at p. 112.) Furthermore, we stated:

[W]e disagree with Pacific’s assertion that until final conditioning costs are adopted, we should set the “nominal prices” for loop conditioning that would be subject to a “retroactive true-up” once TELRIC costs for conditioning are determined.

(D.99-11-050 at p. 114, fn. 103.)

Instead, we directed Pacific to prepare and submit line conditioning cost studies based on TELRIC. (D.99-11-050 at p. 113, fn. 113, and at p. 271, Ordering Paragraph No. 9.) We note that a review of Pacific’s line conditioning costs is scheduled to occur in the line sharing phase of the OANAD docket. (See

Administrative Law Judge's Ruling Addressing Loop Conditioning Cost Studies, June 12, 2000, at p. 2.)

Furthermore, although the decision states that Pacific should be allowed compensation for conditioning, it is unclear whether there should be a separate nonrecurring charge for line conditioning under the TELRIC methodology. As stated by AT&T/MCI in their response:

Given the forward-looking network design that Pacific proposed and developed in its cost studies and that the Commission adopted, no additional non-recurring cost would apply for DSL conditioning because the functionality associated with conditioning is provided as part of the basic network design and reflected as a recurring cost.

(AT&T/MCI Response at p. 9.) The issue of whether a separate nonrecurring charge is appropriate will be addressed in the line sharing phase of this proceeding.

Any inconsistencies in the decision appear to be the result of editing errors in the decision after comments on the proposed decision were received. Thus, we will modify the decision to eliminate the inconsistencies and to clarify our intent.

6. The Use of TELRIC as the Sole Basis for the Pricing Decision

Pacific's final allegation is that UNE prices based only on TELRIC, plus a 19% markup for shared and common costs, violate the Act's requirements that UNE rates be just and reasonable. Pacific asserts that there is no additional markup for profit beyond the capital costs included in the cost studies, and that the Commission precluded the introduction of other types of costs. Pacific also notes that the merits of TELRIC are currently pending before the Eighth Circuit Court of Appeal.

Pacific's argument is in reality an attack on the TELRIC methodology adopted by the FCC and this Commission. As Pacific itself states, "The Act

requires that UNE rates be based on cost. TELRIC systematically understates costs.” (Pacific’s Application for Rehearing at p. 7.) The decision contains a lengthy discussion of Pacific’s pricing proposal, focusing particularly on Pacific’s proposal to include a “risk adder” in the price of UNEs to compensate Pacific for the possibility of future stranded investments. (D.99-11-050 at pp. 17-53.)¹⁰ The decision lists numerous reasons for rejecting the risk adder.

The decision acknowledges at the outset that the proposal is really a collateral attack on the TELRIC methodology. (D.99-11-050 at pp. 37-39.) Nevertheless, the decision analyzes the substance of the proposal. The decision finds that the adder is speculative and ignores similar risks that Pacific incurs for providing retail service. (D.99-11-050 at pp. 39-41.) The decision states that rather than overpricing UNEs by including the risk adder for risks that may never materialize, it is preferable to give Pacific the opportunity to seek recovery of such costs in the future -- if and when Pacific can demonstrate that investments made solely to provide UNEs become stranded because CLECs switch from UNEs to their own facilities. (D.99-11-050 at pp. 42-43.)

The decision also rejects Pacific’s pricing proposal, which is based in part on the risk adder analysis, because it is unsystematic and confers too much pricing discretion on Pacific. (D.99-11-050, at pp. 44-53.) Instead, the decision adopts UNE prices based on TELRIC plus a uniform markup to cover shared and common costs. The decision relies, in part, on the district court order on motions for summary judgment in AT&T Communications of California, Inc v. Pacific Bell, et al. (N.D.Cal. May 11, 1998, No. C97-0080) 1998 U.S.Dist. LEXIS 10103, affd. (9th Cir. 2000) 203 F.3d 1183.) In that case, the court concluded that Pacific’s switched access charges were not “costs” under section 252(d)(1) of the

¹⁰ Prior to the hearings on pricing, AT&T and MCI moved to strike substantial portions of Pacific’s testimony on the ground that it represented an attempt to relitigate costing issues decided in D.98-02-016. The ALJ granted this motion, in part, agreeing with AT&T/MCI that testimony on the alleged inadequacy of TELRIC depreciation rates was an improper relitigation of costing issues. However, the ALJ denied the remainder of AT&T/MCI’s motion, thus allowing Pacific to introduce testimony supporting its proposal for a “risk adder.” (See D.99-11-050 at p. 38, fn. 34.)

Act. “Rather, the Court believes that section 252(d)(1) directs state commissions to set prices that account only for the specific costs incurred in providing the network elements, along with a reasonable profit.” (AT&T Communications of California, Inc v. Pacific Bell, et al., *supra*, 1998 U.S. Dist. LEXIS 10103, at pp. *37-38.)¹¹ Thus, as stated in D.99-11-050, the 1996 Act does not permit regulators to include factors other than costs when pricing UNEs.

Pacific has failed to demonstrate that the decision’s conclusions regarding Pacific’s pricing proposal are in error. Indeed, for the most part, Pacific does not even address the specific points made in the decision. In particular, Pacific fails to discuss how approval of the risk adder can be justified under the Act, the federal regulations, or the case law interpreting the Act.

C. CCTA’s Application

First, CCTA contends that the decision’s determination that certain UNEs are not “essential facilities,” and therefore are not subject to imputation, violates due process and Public Utilities Code section 1708.¹² CCTA also argues that, contrary to the conclusions in the decision, the Commission has treated basic service elements the same as UNEs specified by the FCC, and that the decision’s “essential facilities” analysis constitutes prohibited, de facto recategorization.

Second, CCTA alleges that the decision’s failure to include volume insensitive costs in price floors is arbitrary, not supported by substantial evidence, contrary to D.95-12-016, and unsupported by the necessary findings.¹³

¹¹ The Ninth Circuit found it unnecessary to address the reasoning of the district court because 47 C.F.R. § 51.515(a) prohibits the inclusion of access charges in the pricing of UNEs. This regulation was not in effect at the time of the district court’s decision, but was reinstated by the United States Supreme Court by the time the Ninth Circuit ruling was issued. (AT&T Communications of California, Inc v. Pacific Bell, et al., *supra*, 203 F.3d at 1187.)

¹² Public Utilities Code section 1708 provides that the Commission may rescind, alter, or amend any prior order or decision “upon notice to the parties, and with the opportunity to be heard as provided in the case of complaints.” This section has generally been interpreted to require evidentiary hearings where there are any disputed issues of fact. (See *California Trucking Assn v. Public Utilities Com.* (1994) 19 Cal.3d 240.)

¹³ The issues raised in CCTA’s application are incorporated by reference in Time Warner/Cox’s application.

1. Whether the decision violates due process and/or Public Utilities Code section 1708 in determining that certain UNEs are not “essential facilities”

The question of whether certain UNEs are “essential facilities” was raised by Pacific in the context of the establishment of price floors for Pacific’s competitive (Category II) services.

a) Background

The issue of price floors first arose in D.89-10-031, the decision establishing a new regulatory framework (NRF) for the telecommunications industry. (Re Alternative Regulatory Framework for Local Exchange Carriers [D.89-10-031] (1989) 33 Cal.P.U.C.2d 43.) In that decision, the Commission determined that LECs would have downward pricing flexibility for partially competitive services, which were designated as “Category II” services.¹⁴ However, the Commission also determined that a price floor should be established for Category II services to prevent predatory pricing by LECs.

Predatory pricing may occur if a LEC is able to price a service on the basis of the cost of the service’s monopoly elements, while charging competitors a tariffed rate in excess of cost for those elements. (*Id.* at pp. 127-128.) The Commission stated that, in order to prevent anticompetitive price squeezes, local exchange carriers must impute the tariffed rate of any function deemed to be a monopoly building block (“MBB”) in the rate for any bundled tariffed service that includes the MBB. (*Id.* at pp. 121, 128.) For purposes of pricing, “BSEs” (basic service elements) and “other ONA services” (open network architecture services) were placed in Category I. (*Id.* at p. 126.)¹⁵

¹⁴ The Commission determined that there would be no pricing flexibility for basic monopoly services, designated as “Category I” services, and maximum pricing flexibility for fully competitive services, designated as “Category III” services.

¹⁵ This line of cases uses a variety of different names to describe the same type of network elements: monopoly building blocks (“MBBs”), basic service elements (“BSEs”), basic network functions (“BNFs”), basic network components (“BNCs”), essential services and facilities, monopoly bottleneck

In addition, the Commission approved, in principle, the unbundling of and nondiscriminatory access to monopoly utility services. However, the Commission did not determine which functions were MBBs:

Because of the wide variety of utility services and functions, we are not ready at this time to pass judgment on which functions are or are not monopoly building blocks, nor is the record sufficient to determine whether factors exist which would militate against application of the principles of unbundling and nondiscriminatory access to any specific monopoly building block.

(Id. at p. 121.)

In D.94-09-065, the decision in the implementation and rate design (IRD) phase of the NRF proceeding, the Commission revisited the issue of imputation. (Re Alternative Regulatory Framework for Local Exchange Carriers [D.94-09-065] (1994) 56 Cal.P.U.C.2d 117.) In that decision, the Commission reformulated the imputation test adopted in D.89-19-031 in order to apply it to the toll services at issue in IRD. The new formula, known as the “contribution” method of imputation, was found to be the algebraic equivalent of the imputation standard adopted in D.89-10-031, adjusted for the use of long run incremental costs instead of direct imbedded costs. (Id. at pp. 231-233.) In addition, D.94-09-065 moved some services from Category I to Category II on the basis that such services were either partially competitive or discretionary. (Id. at p. 262.) “Basic Service Elements – other Open Network Architecture services” remained in Category I and, as in the NRF decision, were not specifically defined. (Ibid.)

The Commission next considered price floors in D.96-03-020, a major decision in the local competition proceeding. (Re Competition for Local Exchange Service [D.96-03-020] (1996) 65 Cal.P.U.C.2d 156.) D.96-03-020 moved most local exchange services from Category I to Category II, while

functions, etc. Where appropriate, this order quotes the exact term used in the decision. Otherwise, these elements are generally referred to as basic network elements. When the term “UNE” is used in this order, it refers specifically to an element designated by the FCC pursuant to the 1996 Act.

retaining Category I status for “Basic Service Elements – other Open Network Architecture services.” (*Id.* at pp. 189-190.) Rather than establishing price floors for these services, the Commission left that task to the OANAD proceeding. (*Id.* at p. 191.)

The Commission adopted TSLRIC costs for many local exchange services in D.96-08-021, in the OANAD proceeding. (Re Open Access and Network Architecture Development (1996) 67 Cal.P.U.C.2d 221.) However, the task of setting price floors was suspended after issuance of the FCC’s August 8, 1996 First Report and Order. (See ALJ’s Ruling Suspending Briefing Schedule and Inviting Comments on the Impact of the August 8, 1996 First Report and Order of the FCC, August 21, 1996.) The First Report and Order designated the use of TELRIC costs for pricing UNEs, thus calling into question the legal adequacy of the TSLRIC methodology. An ALJ ruling, issued in the instant docket on December 18, 1996, concluded that the establishment of price floors should take place in the supplementary pricing hearings to be held after the Commission decided whether to use the TSLRIC or the TELRIC methodology. (ALJ’s Ruling Concerning Impact of the August 8, 1996 First Report and Order of the FCC on the Scope of This Proceeding, December 18, 1996.)

b) Discussion

(1) Due Process – Notice to Parties in This Proceeding

CCTA contends that the only imputation issue noticed for this phase of OANAD was whether the imputation formula needed to be adjusted in light of the Commission’s shift from the TSLRIC to the TELRIC methodology for pricing UNEs. According to CCTA, the issue of whether UNEs are essential facilities was not a noticed issue in this proceeding. Thus, CCTA claims a violation of its due process rights under article I, section 7, of the California Constitution. In a related argument, CCTA contends that contrary to the conclusions in the decision,

the Commission has treated BSEs/BNFs/BNCs/MBBs the same as the UNEs specified by the FCC.¹⁶

CCTA first relies on the December 18, 1996 ALJ Ruling that discusses the impact of the FCC's First Report and Order on the instant proceeding. Among other things, that ruling addresses whether TSLRIC or TELRIC should be used for costing unbundled elements, and whether costs must be established for additional unbundled elements pursuant to FCC rules. In addition, the ruling concludes that imputation issues will be reconsidered as well, since "network element prices and price floors ought to be set using a consistent methodology." (ALJ's Ruling Concerning Impact of the August 8, 1996 First Report and Order of the FCC on this Proceeding, December 18, 1996, at p. 29.) According to CCTA, once the Commission adopted the TELRIC methodology (in D.98-02-106), parties were to address only whether the imputation rules required adjustment to reflect the TELRIC methodology and the proper calculation of shared and common costs.¹⁷

CCTA also cites the transcript of the March 16, 1998 prehearing conference (PHC), in which CCTA objected to Pacific Bell's inclusion of the essential facilities issue in its prehearing conference statement. (See R.T. PHC-14, March 16, 1998, pp. 813-952, at pp. 935-943.) CCTA claims that the decision errs in stating that the discussion of this issue at the prehearing conference should have put parties on notice that the essential facilities issue would be litigated in the

¹⁶ As stated above, CCTA presents these allegations separate from its due process and section 1708 arguments. However, it appears that, if accepted, these allegations could lend support to both CCTA's due process and section 1708 arguments.

¹⁷ The December 18, 1996 ruling modified a March 25, 1996 ruling, which identified the basic network functions and services to be priced and the issues to be addressed in testimony. Those issues included: (1) the extent to which certain functions should be unbundled and (2) the setting of price floors for the basic network functions and services to be considered in the hearings. The March 25, 1996 ruling specifically excluded the following issues: (1) the relitigation of imputation rules; (2) geographic deaveraging; and (3) the development of a process for handling future unbundling requests and for recategorizing services.

pricing hearings. CCTA asserts that, at best, the ALJ's remarks at the prehearing conference only added to the confusion regarding which issues would be addressed. CCTA argues that, in any event, any doubts raised at the PHC were removed by the ALJ's March 27, 1998 ruling on the issues for hearing, which failed to mention the issue of whether UNEs are essential facilities. Finally, CCTA claims that regardless of whether Pacific's testimony provided notice of the issue, the Commission itself must provide advance notice to parties.

As stated above, the determination of which UNEs are essential facilities was made for the purpose of imputing the rates of such facilities into competitive Category II retail services using those facilities. The issue was first raised by Pacific in its prehearing conference statement submitted in response to a March 4, 1998 ALJ ruling. (ALJ's Ruling Convening Prehearing Conference to Discuss Issues for Supplementary Pricing Hearings, March 4, 1998.) That ruling, which was issued after the Commission's decision that UNE costs should be based on the TELRIC methodology (see D.98-02-106), set forth a list of issues to be addressed in the supplementary pricing hearings and invited parties to add to the list.

In the PHC held on March 16, 1998, CCTA argued that the essential facilities issue was not an issue in the proceeding. Among other things, CCTA argued that this would be the same as recategorization. Pacific Bell then explained that IRD required imputation of the rate for any monopoly building block to the rate for services that includes the MBB. (See D.94-09-064, supra, 56 Cal.P.U.C.2d at p. 228.) Pacific contended that it must now be decided which UNEs are MBBs for purposes of imputation. The ALJ responded that this appeared to be within the scope of the December 18, 1996 ruling, which noticed reconsideration of the imputation rules. The ALJ then asked whether Pacific's testimony would be addressing recategorization. Pacific answered that it would not; that the essential facilities determination was for the purpose of establishing

retail price floors. (R.T. PHC-14, March 16, 1998, pp. 813-952, at pp. 935-941.) After further discussion, the ALJ noted that if Pacific's testimony were far afield of the issues appropriate for the hearings as established by prior decisions, parties would be filing motions to strike. However, the ALJ concluded that the issues raised by Pacific seemed to respond to D.98-02-106, the decision adopting the TELRIC methodology. (R.T. PHC-14 at p. 943.)

At this point, the parties should have been put on notice that the issue of whether UNEs are essential facilities for purposes of the price floors would be an issue in the hearings. The December 18, 1996 ALJ ruling reopened the issue of imputation. Although the ruling did not specifically notice the issue of whether UNEs are essential facilities, its silence on this issue does not provide support for CCTA's argument. As the ALJ pointed out at the PHC, the essential facilities issue was within the scope of the imputation issue noticed in the December 18, 1996 ruling. Considering the regulatory changes that were taking place after the passage of the 1996 Act, and the fact that the supplementary pricing hearings did not begin until May 1998, nearly 18 months after the December 18, 1996 ruling, it is reasonable that the details of the supplementary pricing hearings would need to be fleshed out at a later date. Moreover, the March 4, 1998 ruling invited parties to add to the list of issues set forth by the ALJ.

As CCTA asserts, the ALJ's March 27, 1998 ruling on the issues for hearing does not include the issue of whether UNEs are essential facilities. However, that ruling only dealt with the issues raised at the PHC that required further deliberation by the ALJ, as noted by the ALJ during the PHC. (See ALJ's Ruling Concerning Issues Raised at March 16, 1998 Prehearing Conference, March 27, 1998.) The ALJ had reached his conclusions about the propriety of admitting evidence on the essential facilities question at the PHC and did not state that further deliberation was necessary.

It is also significant that, although CCTA claims it was not provided sufficient notice, AT&T/MCI apparently had sufficient notice of the issue to submit testimony in opposition to Pacific's. Indeed, AT&T/MCI's testimony was persuasive on the issue of whether loops and switches should be considered essential facilities. (D.99-11-050 at p. 228.)

CCTA claims that regardless of whether Pacific's testimony provided notice of the issue, the Commission itself must provide advance notice to parties. CCTA cites D.97-05-091 (Re Competition for Local Exchange Service (1997) 72 Cal.P.U.C.2d 649), in which the Commission modified a prior decision (D.96-02-072) that concluded that the provision of subscriber listings by a LEC is not an essential service.

As D.99-11-050 points out, the facts in this case are distinguishable from those in D.97-05-091. (See D.99-11-050 at p. 226-227.) D.97-05-091 pertains to a rulemaking proceeding. In that decision, the Commission found notice lacking where the issue came up in Pacific's comments to proposed rules. Parties had no notice that the Commission sought comments on this issue, and consequently put no evidence in the record to refute Pacific's proposal. In contrast, the parties to this proceeding were provided notice of the essential facilities question prior to evidentiary hearings and were allowed the opportunity to submit evidence. Moreover, in this case, evidentiary hearings were held and a sufficient record was developed to support the Commission's conclusions.

CCTA also argues that, contrary to the decision, the Commission has treated basic network elements (as described in pre-1996 decisions) the same as UNEs specified by the FCC rules.¹⁸ CCTA's argument is without merit. CCTA's own table comparing the FCC's UNE list with Commission lists of basic network elements indicates that they are not the same. (See CCTA's Application for

¹⁸ It appears that this argument is intended to lend support to both CCTA's due process and Public Utilities Code section 1708 contentions.

Rehearing at pp. 12-13.) Moreover, because most of the decisions CCTA relies upon were issued prior to the passage of the 1996 Act, they are not relevant to its contention that the Commission has treated basic network elements and UNEs the same. Finally, as pointed out in the decision (D.99-11-050 at p. 216), although decisions such as NRF (D.89-10-031) and IRD (D.94-09-065) require imputation for MBBs or BSEs, they do not identify which elements or functions are to be considered in these categories.

Although the Commission acknowledges in the decision that it could have provided better notice on this issue (D.99-11-050 at p. 228), the notice did not violate CCTA's due process rights, particularly when viewed in the context of this case and the impact of the 1996 Act on this case. The 1996 Act set up a whole new structure and process for the entry of competitors into the local exchange market. The FCC's UNE list did not correspond to the elements that the Commission envisioned for unbundling prior to the passage of the Act and First Report and Order. Indeed, this was acknowledged in the December 18, 1996 ALJ Ruling. (ALJ's Ruling Concerning Impact of the August 8, 1996 First Report and Order of the FCC on this Proceeding, December 18, 1996, at p. 6.) By March 4, 1998, when the ALJ set the PHC for the supplementary pricing hearings, prior Commission determinations of basic network elements for purposes of unbundling had been supplanted by the FCC's UNE list. As Pacific stated in hearings, the NRF categories simply did not fit into the UNE framework set up by the Act. (See R.T. Volume 44, pp. 6552-6553; D.99-11-050 at p. 224.)

(2) Section 1708 – Notice to Parties in Other Proceedings

CCTA argues that the elimination of the imputation requirement for certain UNEs violates both due process and Public Utilities Code section 1708 because it modifies D.89-10-031, Re Alternative Regulatory Framework for Local Exchange Carriers (1989) 33 Cal.P.U.C.2d 43 (the NRF Decision), D.94-09-065 Re Alternative Regulatory Framework for Local Exchange Carriers (1994) 56

Cal.P.U.C.2d 117 (the IRD decision), and D.96-03-020, Re Competition for Local Exchange Service (1996) 65 Cal.P.U.C.2d 156 (the Local Competition decision instituting the resale of local exchange service by competitive local carriers) without notice and opportunity to be heard for all of the parties in those proceedings.

CCTA also argues that the essential facilities findings constitute de facto recategorization of certain UNEs as non-monopoly building blocks and are prohibited. CCTA points out that a Category I service is, by definition, a monopoly service. According to CCTA, the decision's determination that some UNEs are not essential for the purpose of imputation is inconsistent with the Category I definition.

CCTA cites D.94-10-040, Re Regulation of Cellular Radiotelephone Utilities (1994) 56 Cal.P.U.C.2d 621. That case involved a decision that had modified a prior order of the Commission regarding the temporary tariff procedure used by cellular carriers. The Commission granted rehearing of the decision because the only notice of the issue was in comments to an assigned commissioner ruling. The Commission stated: "Section 1708 requires the Commission, not parties, to provide notice of any modification, alteration, amendment or rescission of one of its decisions."

If the Commission modifies a prior decision, the usual practice is to provide notice to all parties involved in the proceeding that resulted in that decision. However, in this case, the Commission did not modify decisions in the NRF and Local Competition dockets as claimed by CCTA. As stated above, the decisions cited by CCTA do not specify which elements were to be considered MBBs/BSEs. Moreover, the instant decision is consistent with prior decisions stating that the rates for MBBs/BSEs should be imputed for retail services using such elements. That is precisely what the decision did.

Regarding the issue of de facto recategorization, the NRF categories were established to indicate the degree of pricing flexibility LECs had over services, rather than elements. In NRF, the price floors, which included tariffed rates of MBBs, were used to determine prices of Category II services. As stated previously, the BSEs and other ONA services designated as Category I were not identified.

In addition, the essential facilities determination in the instant decision does not change the category of any service or element. As argued by Pacific (see Reply of Pacific to Motions of AT&T et al. and CCTA to Strike Portions of Pacific's Testimony, May 11, 1998, at pp. 13-14), Pacific was not seeking to shift any services or elements from Category I to Category II, nor to achieve Category II downward pricing flexibility, nor to set price floors for UNEs. The pricing of network elements was determined pursuant to the 1996 Act, which requires that certain UNEs be offered on an unbundled basis. In this sense, there is a disconnection between the NRF categories and the FCC's list of UNEs, as Pacific has asserted. (See R.T. Volume 44, May 22, 1998, pp. 6494-6637, at pp. 6552-6553.)¹⁹

CCTA's argument is also further weakened by the internal inconsistency of CCTA's position. CCTA is essentially arguing that all UNEs must be considered Category I monopoly elements. However, CCTA's argument, if accepted, would also necessitate "recategorization" because the UNE list is broader and different from the Commission's list of MBBs/BSEs/BNFs. (See, e.g., ALJ's Ruling Concerning Impact of the August 8, 1996 First Report and Order of the FCC on this Proceeding, December 18, 1996, at p. 6.) Finally, CCTA never identifies any specific elements that should be considered monopoly elements that have been determined not to be essential elements. As stated above,

¹⁹ In addition, contrary to CCTA's argument, a finding that a UNE is not an essential facility is not necessarily synonymous with recategorization, which is determined by whether a service or element is partially competitive or discretionary.

clearly, not all UNEs should be considered monopoly elements if the Commission previously determined that such services/elements were not in Category I.

c) Conclusion

While the notice provided by the Commission could have been improved, as the decision itself notes (D.99-11-050 at p. 228), CCTA was informed during the PHC that Pacific would be allowed to put in testimony on whether certain UNEs should be considered essential facilities. Moreover, the record supports the substantive findings regarding essential facilities. Indeed, AT&T's testimony, submitted on the basis of the same notice given to CCTA, was persuasive in the determination of which UNEs are essential for imputation purposes. Similarly, on the recategorization issue, the decision only uses the essential facilities determination for the purposes of imputation and setting price floors. For all of these reasons, CCTA has not demonstrated legal error in the decision.

2. Whether the decision errs in failing to include volume insensitive costs in price floors

CCTA contends that the decision's failure to include volume insensitive costs in price floors is arbitrary, not supported by substantial evidence in the record as a whole, and contrary to D.95-12-016 (Re Open Access and Network Architecture Development (1996) 62 Cal.P.U.C.2d 575.) CCTA also alleges that the decision fails to make necessary findings on this issue. While agreeing with the decision's rejection of Dr. Emerson's proposed tests for cross-subsidy (see D.99-11-050 at pp. 215, 254, Finding of Fact Nos. 86-88, 266, Conclusion of Law No. 77), CCTA asserts that the decision errs when it concludes that the Commission's adopted TELRIC methodology and use of contribution imputation for loop and switching will provide sufficient protection against cross-subsidy. (D.99-11-050 at p. 215.) CCTA argues that this error occurs because the adopted price floor methodology includes no explicit method for ensuring

recovery of service-specific volume sensitive costs, in violation of Consensus Costing Principles Nos. 1 and 3 in D.95-12-016.

The decision contains a lengthy analysis of the questions involved in setting price floors for the retail services at issue in this case. (D.99-11-050 at pp. 205-243.) The cross-subsidy issues raised by CCTA in its application were raised during hearings, by one party or another, and addressed by the Commission. The decision explains, based on the testimony of the parties, why the contribution method of imputation remains valid, why only the volume-sensitive portion of the TSLRIC of a service should be used in setting floors, and why the risk of cross-subsidy is reduced by starting with the TELRIC-based UNE prices in computing contribution. (D.99-11-050 at pp. 205-216.) Contrary to CCTA's assertions, the decision contains findings of fact and conclusions of law to support its analysis. (D.99-11-050 at pp. 254-255, [Findings of Fact Nos. 85-88] and pp. 266-267 [Conclusions of Law Nos. 74-80].)

Finally, the costing principles cited by CCTA were developed prior to the Commission's decision to use TELRIC instead of TSLRIC. Under TELRIC, many costs that would be considered "shared" or "common" under TSLRIC are instead assigned directly to the network element. This reduces the risk of cross-subsidy. (D.99-11-050 at p. 266, Conclusion of Law No. 78.) For all of the foregoing reasons, CCTA has failed to demonstrate any legal error in the methodology used to set price floors.

D. Joint Application of Time Warner/Cox

Time Warner/Cox argue that D.99-11-050 errs in failing to require UNE rates to be tariffed. Time Warner/Cox rely on Public Utilities Code sections 489, 491 and 495.²⁰

The Commission declined to order the tariffing of UNE prices, noting that the United States Supreme Court's reinstatement of the "pick and choose" rule

²⁰ As stated above, Time Warner/Cox also incorporate by reference all of the issues raised by CCTA.

made the debate over whether to tariff UNE prices largely moot.²¹ (D.99-11-050 at p. 165.) The “pick and choose” rule provides, in part:

An incumbent LEC shall make available without unreasonable delay to any requesting telecommunications carrier any individual interconnection, service, or network element arrangement contained in any agreement to which it is a party that is approved by a state commission pursuant to section 252 of the Act, upon the same rates, terms, and conditions as those provided in the agreement.

(47 C.F.R. § 51.809.)

First, Time Warner/Cox contend that the decision errs in only requiring the UNE prices adopted in this proceeding to serve as a benchmark for arbitrated agreements. This contention relies on language in the decision that discusses the purposes for which the adopted UNE prices would be used. The decision orders the UNE prices to be incorporated into all existing interconnection agreements that were reached through arbitration, pursuant to Resolution ALJ-174. (D.99-11-050 at p. 269, Ordering Paragraph No. 3.) In addition, the decision determines that the UNE prices will serve as a benchmark for network element prices contained in interconnection agreements submitted to the Commission for arbitration after the expiration of the existing interconnection agreements. (*Id.* at pp. 168-169.)

However, contrary to Time/Warner Cox’s assertions, the decision does not state that the UNE prices are to be used only in arbitrated agreements. The intent of the decision was not to limit the use of the UNE prices. Rather, the decision clarifies that, in addition to incorporating the prices into existing agreements, the Commission would use the prices as a benchmark in arbitrating

²¹ The “pick and choose” rule was vacated by the Eighth Circuit Court of Appeals in *Iowa Utilities Board v. FCC* (8th Cir. 1997) 120 F.3d 753, 801. In *AT&T v. Iowa Utilities Board* (1999) 119 S.Ct. 721, 738, the United States Supreme Court reinstated the rule.

future agreements. Indeed, the decision itself quotes the “pick and choose” rule, which, pursuant to section 225(i) of the 1996 Act, mandates that the prices, terms and conditions of any approved arbitrated or negotiated agreement shall be made available to any requesting telecommunications carrier.

Second, Time Warner/Cox argue that Public Utilities Code sections 489, 491 and 495 require the tariffing of UNE prices. Section 489 provides, in part:

The commission shall, by rule or order, require every public utility other than a common carrier to file with the commission within the time and in the form as the commission designates, and to print and keep open to public inspection, schedules showing all rates, tolls, rentals, charges, and classifications collected or enforced, together with all rules, contracts, privileges, and facilities which in any manner affect or relate to rates, tolls, rentals, classifications, or service.

(Emphasis added.) In addition to the language of section 489, Time Warner/Cox rely on D.97-04-090 (Re Competition for Local Exchange Service (1997) 72 Cal.P.U.C.2d 374) and D.96-03-020 (Re Competition for Local Exchange Service (1996) 65 Cal.P.U.C.2d 156), which order the tariffing of wholesale rates for the resale of local exchange service.²²

Time Warner/Cox’s reliance on section 489 is misplaced. Although section 489 requires that rates be filed with the Commission, it does not require that all rates be included in tariffs. (Pub. Util. Code § 489; General Order 96-A, section X, “Contracts and Services at Other Than Filed Tariff Schedules.”) Rate schedules or tariffs contain rates, terms and conditions that are applicable to all customers or carriers. Contracts contain rates, terms and conditions that are applicable to specific customers or carriers. The UNE prices established in this

²² Section 491 address changes in rates or classifications. Section 495 requires telephone corporations to file rate schedules showing all rates for the transmission of messages between all points within the state and all points outside the state upon its routes. These sections do not appear to add anything of relevance here to the requirements of section 489.

proceeding are for purposes of interconnection agreements or contracts between specific carriers.²³ Therefore, section 489 does not require that the UNE prices be tariffed; it only requires that the interconnection agreements be filed with the Commission.

Resolution-181 requires parties to file copies of interconnection agreements with the Commission, whether reached by mediation, negotiation or arbitration.²⁴ (See Rules 4.1.1, 4.2.1, and 4.3.1.) In addition, final conformed agreements are to be filed in electronic form. (See Rule 1.2.) The rules also require that parties submit amendments to any approved agreements to the Telecommunications Division by Advice Letter. (See Rule 6.1.) Thus, the filing procedures for interconnection agreements under Resolution ALJ-181 satisfy the mandates of Public Utilities Code section 489.

As the decision concludes, it is also unnecessary as a matter of policy to include UNE prices in tariffs. (D.99-11-050 at p. 165.) Under the section 251(i) of the 1996 Act (47 U.S.C. 251(i)) and the “pick and choose” rule (47 C.F.R. § 51.809), the rates, terms, and conditions of one contract are available to all carriers. Although Time Warner/Cox contend that Pacific has entered into non-disclosed memoranda of understanding that amended interconnection agreements, the nondisclosure of rates, terms, or conditions is not permitted under state or federal law. As stated above, Pacific is required to file with the Commission any negotiated or arbitrated interconnection agreements, as well as amendments to such agreements. Moreover, such agreements are available for public inspection.

²³ Although the contract terms are available to all carriers under the “pick and choose” rule, carriers are free to negotiate any terms they wish under the 1996 Act as long as the resulting agreement does not discriminate against any other carrier and is not contrary to the public interest. (See 47 U.S.C. § 252 (e)(2).) Thus, there may be deviations from the adopted UNE rates if agreed to by the parties to the contract and approved by the Commission. In contrast, tariffed rates and terms are not altered by negotiation between specific parties.

²⁴ Resolution ALJ-181, revising Resolution ALJ-178, contains the rules governing filings made pursuant to section 252 of the Telecommunications Act of 1996.

(See Resolution ALJ-181 and 47 U.S.C. § 252 (h).) Therefore, the “pick and choose rule” renders the contract prices similar to tariffed rates in terms of availability to other carriers.

For the foregoing reasons, Time Warner/Cox have not demonstrated any legal error in the decision.

E. TURN’s Application

TURN’s application for rehearing is more in the nature of a request for clarification of the decision. In both its testimony and comments, TURN recommended that the Commission should either (1) credit universal service revenues on a per line basis against the price floor, or (2) order that universal service revenues be taken into account in considering whether residential basic services are priced above the floor. TURN states that “its motivation was to ensure that universal service revenues be treated as revenues attributable to basic exchange service in any future proceeding in which the repricing of basic exchange services may be considered.” (TURN’s Application for Rehearing at p. 1.) The decision concludes that reflecting Pacific’s universal service revenues in price floors would be inappropriate and rejects TURN’s proposal. (D.99-11-050 at p. 235, fn. 196.)

TURN states that it no longer is pursuing its first alternative of crediting universal service revenues on a per line basis against the price floor. However, TURN contends that to the extent the decision can be read to reject its second alternative, it is erroneous and contrary to Commission precedent. TURN argues that the Commission has already found that universal service revenues should be included when assessing whether a price exceeds the floor. TURN cites D.98-07-091 at pp. 15-16 (modifying Re Competition for Local Exchange Service [D.96-03-020] 65 Cal.P.U.C.2d 156, 213, Conclusion of Law No. 49). TURN claims that the issue raised in its application for rehearing only relates to retail pricing, not UNE pricing. (TURN’s Application at p. 3, fn. 6.)

The decision explicitly rejects only TURN's first proposal. It appears from the decision that we did not intend to reach the issue of whether universal service subsidies should be taken into account in setting retail prices, which is beyond the scope of this proceeding. TURN requests that the Commission modify footnote 196 to state:

We reject TURN's proposal to credit [universal service] revenues on a per-line basis against the price floors. However, we agree with TURN that applicable [universal service] revenues should be included in revenues received in determining whether the price of a residential basic exchange services is above the floor price.

Rather than adopt this language, we will simply clarify that our decision did not reach TURN's second proposal, which relates only to retail pricing.

F. Other Procedural Issues

AT&T/MCI filed a motion for leave to file under seal the proprietary version of their joint application for rehearing. No party opposes this motion. The proprietary version contains figures relating to Pacific's price floor for flat-rate residential basic exchange service, the amount of Pacific's universal service subsidy, and the amount of Pacific's revenue from Yellow Pages. The ALJ in this proceeding has previously ruled that information such as this may be submitted under seal. Therefore, we will grant AT&T/MCI's motion.

New Edge Network, Inc. ("New Edge") filed a petition for leave to participate in the proceeding in opposition to Pacific's application for rehearing. New Edge supports AT&T/MCI's arguments in opposition to Pacific. We will grant New Edge's petition solely for the purpose of filing its opposition. However, allowing New Edge to file its opposition does not make it a party to the proceeding, and New Edge shall have no right to apply for rehearing or to appeal the decision under Public Utilities Code sections 1731 and 1756.

Requests for oral argument were filed by CCTA and Time Warner/Cox. It does not appear that oral argument would materially assist the Commission in resolving the applications. (See Rule 86.3 of the Commission's Rules of Practice and Procedure.) Therefore, the requests for oral argument are denied.

Therefore, **IT IS ORDERED** that:

1. Decision ("D.") 99-11-050 is modified as follows:
 - a. On pages 113 and 114, delete the language starting with the first new paragraph on page 113 ("While we agree that it would be unfair . . .") through the bottom of page 114, including footnotes 100 through 103.
 - b. Replace the deleted language with the following:

Moreover, in the Revised UNE List Order issued on November 5, 1999, the FCC explicitly provided that loop conditioning charges must be based on forward-looking cost principles, and must comply with the rules for non-recurring costs set forth in 47 C.F.R. § 51.507(e). (See ¶¶ 172, 194; Appendix C, § 51.319(a)(3)(B) and (C).)

Thus, although as a matter of policy we believe that Pacific should be allowed to recover reasonable loop conditioning costs, Pacific has not presented the Commission with an appropriate charge. We hereby direct Pacific to begin preparation immediately for submitting line conditioning cost studies based on the TELRIC methodology. At an appropriate point in the future, we will instruct Pacific (and other parties interested in submitting their own line-conditioning studies) in what docket these studies should be submitted.

Until we can determine whether a separate charge for DSL conditioning should be adopted, and what that charge should be, Pacific should receive the non-recurring charge applicable to ISDN loops for all 2-wire loops used to provide digital subscriber line service. We disagree with Pacific's assertion that until final conditioning costs are adopted, we should set

“nominal prices” for loop conditioning that would be subject to a “retroactive true-up” once the TELRIC costs for conditioning are determined. (Pacific’s Opening Comments, p. 16.) As Northpoint emphasizes in its reply comments on the PD, Pacific has offered no specifics about what these “nominal prices” should be. (Northpoint Reply Comments, pp. 1-2.) Moreover, in order to promote commercial stability, we have generally disfavored the use of true-ups for interconnection agreements. For example, Resolution ALJ-174, at p. 2, states that the rates adopted in the Commission’s OANAD pricing decision or decision shall be substituted for the interim UNE rates in arbitrated interconnection agreements “on a forward basis.”

In the PD that was issued on May 10, 1999, we restricted our discussion of digital subscriber line service to ADSL. The parties’ comments on the PD make clear, however, that there are currently two types of digital subscriber line service, ADSL and IDSL. ADSL service uses a 2-wire copper loop; it requires that the customer be located within 3 miles of the central office where the loop originates. IDSL service, on the other hand, uses an ISDN loop; it allows the customer to be located as much as 5 miles from the originating central office.

Although Covad’s testimony and briefs concerned ADSL service, its comments on the PD address mainly IDSL service. Covad argues strenuously that

- c. On page 261, replace Conclusion of Law No. 45 with the following:

Although as a matter of policy we believe that Pacific should be allowed to recover reasonable loop conditioning costs, Pacific has not presented the Commission with an appropriate TELRIC-based charge.

- d. On page 261, replace Conclusion of Law No. 47 with the following:

Until we can determine whether a separate charge for DSL conditioning should be adopted, and what that charge should be, Pacific should receive the non-recurring charge applicable to ISDN loops for all 2-

wire loops used to provide digital subscriber line service.

- e. On page 261, delete Conclusion of Law No. 48.
2. Rehearing of D. 99-11-050, as modified, is denied.
3. The motion made by AT&T Communications of California, Inc. and MCI WorldCom Network Services, Inc. to file under seal the proprietary versions of their joint application for rehearing is granted.
4. The petition of New Edge Network, Inc. to participate in this proceeding solely for the purpose of opposing Pacific Bell's application for rehearing is granted.
5. Requests for oral argument by California Cable Television Association ("CCTA"), Time Warner Telecom of California, L.P., and Cox California Telcom, L.L.C. d/b/a Cox Communications are denied. This order is effective today.

Dated May 24, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners